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COMMISSION STAFF WORKING DOCUMENT

SUMMARY OF THE IMPACT ASSESSMENT

Accompanying document to the

- 1. Draft Commission Directive implementing Directive 2009/65/EC of the European Parliament and of the Council as regards certain provisions concerning fund mergers, master-feeder structures and notification procedure;**
- 2. Draft Commission Directive implementing Directive 2009/65/EC of the European Parliament and of the Council as regards organisational requirements, conflicts of interest, conduct of business, risk management and content of the agreement between a depositary and a management company;**
- 3. Draft Commission Regulation implementing Directive 2009/65/EC of the European Parliament and of the Council as regards the form and content of the standard notification letter and UCITS attestation, the use of electronic communication between competent authorities for the purpose of notification, and procedures for on-the-spot verifications and investigations and the exchange of information between competent authorities;**
- 4. Draft Commission Regulation implementing Directive 2009/65/EC of the European Parliament and of the Council as regards key investor information and conditions to be met when providing key investor information or the prospectus in a durable medium other than paper or by means of a website.**

This report commits only the Commission's services involved in its preparation and does not prejudice the final form of any decision to be taken by the Commission.

1. PROBLEM DEFINITION

The UCITS Directive sets a regulatory framework for retail funds at the European level and a basis for cross-border sales of these funds, and has been considered largely effective in delivering a well-functioning retail fund market in the EU. At the end of 2009 the assets under management of UCITS funds were slightly above €tr.

There have been concerns however as to the efficiency, competitiveness and integration of the UCITS market and the effectiveness of investor protection standards. These concerns led, following a structured process including two separate impact assessments, to the adoption of changes to the UCITS (Undertakings for Collective Investment in Transferable Securities) Directive in July 2009 (2009/65/EC, also referred to as UCITS IV).¹

The changes focused on four groups of measures, designed to:

- facilitate the **provision of management services on a cross-border basis** (a so-called ‘management company passport’ or MCP), including general improvements to the regulatory framework governing the conduct of business and risk management of UCITS;
- improve retail **pre-contractual disclosures** about the funds;
- facilitate **asset pooling** (by means of cross-border mergers and a new concept of ‘master’ and ‘feeder’ UCITS); and
- streamline the steps UCITS need to take to be sold cross-border (the **notification procedure**).

The level 1 Directive, adopted via the co-decision procedure, created a basis for the development of more detailed (level 2) implementing measures, to be adopted by the Commission to support the changes made in these four areas. The Directive strongly defined the scope and nature of such measures, and clearly distinguished between those areas where they must be adopted, and areas where discretion is granted to the Commission.

In total there are **19** distinct issues for implementing measures that have been so identified. However, for most the impact for stakeholders can be seen to be negligible, and impacts are driven by the changes made already at level 1. For this reason this impact assessment focuses on the subset of these issues (five in total) where choices at level 2 are likely to have a significant impact.

Given that the financial crisis has highlighted the importance of ensuring that all financial sectors contribute effectively to systemic stability, these issues also are being considered in relation to possible refinements to promote stability. This has led to the addition of specific issues on UCITS risk management.

¹ OJ L 302, 17.11.2009, p. 32–96, <http://eur-lex.europa.eu>

1.1.1. ISSUE 1: Organisational requirements, rules on conflicts of interest and rules of conduct for management companies

Inconsistent approaches have emerged between Member States as to the general rules that apply to the basic functions of the management company. Several Member States have already applied relevant MiFID provisions to UCITS; others have not done so. This undermines the effective functioning of the MCP and creates inefficiencies and investor protection issues in the UCITS market. The UCITS IV level 1 provisions therefore require the Commission to adopt detailed rules in this area.

1.1.2. ISSUE 2: Risk management

Inconsistencies in general conduct of business requirements applied to UCITS in different Member States also affect risk management. Other inconsistencies have also emerged on Member States requirements on risk identification, measurement and management, including divergent implementations of the UCITS Directive. UCITS IV level 1 requires the Commission to adopt detailed rules in this area.

1.1.3. ISSUE 3: Pre-contractual disclosures

Rules on investor disclosures vary between Member States and are generally ineffective, with documents that investors find too complex, difficult to read, un-engaging, and difficult to compare and understand. In the absence of effective disclosures, there is the danger that investors mis-buy or are mis-sold inappropriate funds. UCITS IV level 1 requires the Commission to develop highly harmonised and standardised requirements for a pre-contractual disclosure document, in the form of a 'key investor information' document, to address these issues.

1.1.4. ISSUE 4: Means of providing information about asset pooling

UCITS IV creates a new framework to enable asset pooling through cross-border fund mergers and master-feeder structures. This raises particular investor protection issues relating to the possible transformation of funds through mergers or into or out of a master-feeder arrangement. The Directive gives investors rights to leave a fund where such transformations are contemplated, and requires information to be provided about the transformation. The means of provision of this information is not determined at level 1, but the Commission is empowered to consider whether it is necessary to harmonise arrangements for delivery of this information to investors.

1.1.5. ISSUE 5: Details of notification procedures

UCITS IV simplified the procedures by which a UCITS can gain access to another EU market cross-border by notifying the relevant competent authorities. There is a significant risk that inefficiencies in this process might be a barrier to the single market. In order to address this, amongst other changes the Directive provided for the establishment of effective (electronic) communication between authorities, and empowered the Commission to identify whether it is necessary to harmonise further the procedure for electronic communication between authorities.

2. ANALYSIS OF SUBSIDIARITY

The level 1 revision of UCITS IV mainly sought to improve the effective functioning of the UCITS framework. Changes to that framework – by necessity – can only be made at the European level. The implementing measures examined in this impact assessment are in large part mandated or determined by these level 1 changes. The legal basis for action is provided by and delimited by the implementing powers created within the UCITS IV Directive.

The Commission's analysis is that action solely at Member State level would not be able to address the issues that level 2 measures are being designed to address, the main reasons being the centrality of the single market and cross-border dimension to the UCITS market and the key function of European law in defining the framework in which this market operates. Action solely at Member State level would run the risk of erecting or maintaining barriers to further integration and efficiency in the UCITS market as a whole, including barriers to UCITS that operate on a cross-border basis; inconsistencies between Member States potentially could raise systemic risks and risks to investors in UCITS, whilst also increasing costs.

3. OBJECTIVES OF EU INITIATIVE

The implementing measures are designed to deliver on the same strategic objectives as level 1 – to drive the UCITS framework forwards by ensuring it is more efficient and competitive, better able to protect investors but also free from unnecessary costs and administrative burdens. In more detail, the key problems identified at level 1 (outlined above) also provide the framework for level 2 objectives. More targeted objectives however naturally apply at level 2:

- ensuring effective and consistent requirements on the conduct of management companies and its supervision, so as to build mutual supervisory confidence cross-border, and, ensure effective and consistent risk management;
- building detailed and effective requirements for the harmonisation and standardisation of pre-contractual disclosures;
- ensuring that investor protection measures remain effective given the new flexibility provided for in master-feeder and merger frameworks;
- ensuring efficiency, effectiveness and security in communications mechanisms in the new notification procedure.

4. POLICY OPTIONS

Three of the five issues being addressed relate to areas in which the Commission is obliged, by level 1, to adopt implementing measures, where level 1 defines clearly the scope and nature of these measures. Despite this, there are significantly different options as regards the contents of measures in these areas. The remaining two issues are in areas in which the Commission is not bound to act by level 1. The baseline for these two issues is therefore different, in that no action is a valid option.

Analysis of policy options has been conducted on the basis of detailed technical advice from CESR, on which CESR consulted widely with stakeholders, in a manner that is consistent with the standards the Commission applies to its own consultations. The Commission also initiated external studies on options on pre-contractual information, including testing of possible content with investors, given the complexity and importance of this area.

Retained options - Measures on which the Commission is obliged to act

1	<p>Rules for management companies</p> <p>The key issue was whether requirements should be aligned with Markets in Financial Instruments Directive (MiFID)².</p> <p>A number of Member States have already aligned requirements on the conduct of UCITS management companies with MiFID, leading to an unlevel playing field between UCITS. Some degree of specificity of requirements to address the particular issues faced by management companies is nonetheless unavoidable. The retained option was to seek as much alignment with MiFID as possible.</p>
2	<p>Risk management</p> <p>The key issue related to the extent to which detailed requirements on risk management and measurement should be harmonised. The retained option is for a hybrid solution, harmonising a framework and principles at level 2 but supported by level 3 guidance on details (to be adopted by Member States within CESR).</p>
3	<p>Pre-contractual disclosures</p> <p>The key issues related to the precise form and content of specific disclosures. Different options were tested with investors, and the most effective in investor protection options selected. The overall package of disclosure options was also tested with industry to assess costs of implementation.</p>

Retained options - Measures where the Commission has discretion on whether to act

4	<p>Means of providing information to investors on asset pooling</p> <p>The key issue related to the extent to which an active communication of information was necessary to achieve investor protection goals. CESR advice proposed no further action at EU level on this issue, which implicitly meant a passive approach to communication in a number of key markets. However the analysis concluded that this was incompatible with the investor protection outcomes being sought, and a more active solution was thereby necessary.</p>
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² Directive 2004/39/EC: OJ L 145, 30.4.2004, p. 1–44; Commission Regulation (EC) 1287/2006 OJ L 241, 2.9.2006, p. 1–25 implementing Directive 2004/39/EC and Commission Directive 2006/73/EC OJ L 241, 2.9.2006, p. 26–58 implementing Directive 2004/39/EC; <http://eur-lex.europa.eu/>

5 Details of notification procedures

There are two key issues here. The first is the degree of harmonisation needed for procedures for the transmission of notification files between competent authorities. The second is the extent to which sophisticated centralised IT systems should be developed to drive potential efficiencies across the EU market as a whole given the scale of notifications. As to the former, the analysis concluded that it is appropriate to harmonise these procedures further to ensure the benefits introduced by changes at level 1 of the UCITS Directive. As regards the latter, time constraints prevented any such solution being developed now, but there appears to be a strong case for such an approach in the future, depending on further detailed development work. An impact analysis of detailed proposals will be necessary, but these steps can be taken without binding requirements at level 2 through action by Member States themselves.

5. ASSESSMENT OF IMPACTS

- *Overall package*

- *Costs*

- In assessing the overall impact of the proposed implementing measures, the key cost drivers identified at level 1 remain dominant. The incremental impact of level 2 measures is generally difficult to isolate. Following analysis, there are however **three** areas where level 2 implementing measures are likely to have material and significant impact. These are the measures relating to the management company passport, those relating to the risk management processes of companies, and those relating to mergers and master-feeder structures. In these areas level 2 solutions are likely to create material adjustment costs for firms in complying with more detailed requirements, and for their supervisors in monitoring their implementation. Estimates are that alignment with MiFID rules could be in the range of EUR 300-150 million in one-off costs and EUR 250-80 million in ongoing costs across the industry as a whole. Adjustments in regards risk management and measurement could trigger further EUR 75-35 million in one-off costs and EUR 60-20 million in ongoing costs. Compliance costs related to provision of information to investors related to transformation to asset-pooling arrangements are likely in jurisdictions in which active provision of information to investors is not customary; estimates are that this could lead to costs of EUR 400 million to the industry.
- Given that level 1 determined the necessity for a harmonised pre-contractual disclosure for retail clients, the costs of harmonisation as such are primarily determined by the level 1 changes; the incremental impact of the specific options chosen for the content and form of the document are by comparison marginal. However, the recently conducted study on the costs and benefits of the proposals provides an indication of the impact of the changes at level 1 of the UCITS Directive. Estimates are that the new requirements may be around 7.5% greater in cost for the industry than the current simplified prospectus.
- As regards measures on notification procedures, these by definition do not apply to every UCITS, and costs will depend on the number of UCITS impacted; the

costs for firms in these areas are considered to be minor in comparison to the changes at level 1.

- Synergies are expected between measures, notably between the pre-contractual disclosure requirements and those on improving the efficiency of the notification procedure and on ensuring investor protection in relation to mergers and master-feeder structures.

The package of proposals is also likely to impact supervisors, leading to one off costs of change, but potentially laying the basis for some savings through efficiency gains and greater clarity over respective roles.

Benefits

The overall UCITS IV package is expected to deliver competition, efficiency and consumer protection benefits, consistent with the analysis supporting level 1 -- increased cross-border activity, rationalisation in the UCITS market, more informed investment decisions with attendant reductions in levels of consumer complaints. The quantification of these benefits is extremely difficult *ex ante*, given the delivery of these benefits depends on an uptake of new possibilities that is difficult to forecast. The benefits are also largely driven by level 1 changes rather than level 2. Nonetheless, greater consistency between the UCITS and MiFID frameworks should drive down compliance costs while improving legal certainty and clarity.

Regarding investor protection measures, better informed investors can be expected to be better able to protect their own interests. This should lead to increasing confidence in the UCITS market and reducing levels of investor detriment and complaints. The scale of any such effects is likely to become most apparent *ex post*, and so would be a good candidate for further monitoring.

- ***Administrative burden***
- Screening of the proposed implementing measures did not identify any major incremental administrative costs at level 2 that would be material for the industry or other stakeholders. The only material impact in terms of administrative costs is contained in the measures related to provision of information to investors in cases of a merger or changes to a master-feeder structure. The estimated compliance costs of EUR 400 million can be considered in their entirety as a measure of the administrative burden.

Risks to delivery

The goals of reducing barriers to cross-border business and to promote asset pooling may be strongly hampered by factors outside the control of the UCITS framework, such as national rules on marketing and tax issues. Further, it is difficult *a priori* to strike the optimum balance between prescription and flexibility -- the success of the MCP depends now on how well supervisors cooperate in practice and how far the new framework has laid an effective basis for the regulation of the UCITS market.

The success of the measures is also dependent on the commitment of management companies and supervisors. For instance, the success of pre-contractual disclosure documents depends on firms' commitment of resources to ensuring they are written plainly and clearly presented.

6. MONITORING AND EVALUATION

A number of monitoring and evaluation measures were outlined in the level 1 impact assessment, such as steps to check the effectiveness of the new MCP and asset-pooling mechanisms through ongoing economic analysis and monitoring of readily available market data by the Commission. Specific additional steps are foreseen for level 2, including implementation tests regarding alignment with MiFID and analyses of the new risk management approaches that emerge and their consistency and effectiveness. The effectiveness of the measures on mergers and master-feeder structures will depend on the extent to which firms avail themselves of these new frameworks. If they do not, it will be necessary to assess why; if they do, then the effectiveness of investor protection steps will require careful monitoring.

Further studies are envisaged in two areas. The first relates to the new framework for risk management, so as to assess its effectiveness in capturing and managing the risks faced by UCITS. The second relates to the proposed ‘synthetic risk indicator’ in the KII – this is a novel disclosure, and could specifically benefit from ex-post analysis on its effectiveness for investors and its impact on the market.